

IRS TAX TIP 2004-45

DON'T BE TAKEN IN BY TAX SCAMS

The IRS reminds taxpayers not to fall victim to a variety of tax scams. These schemes take numerous shapes, ranging from promises of special tax refunds to illegal ways of “untaxing” yourself.

If you think something may be unscrupulous, you can report suspected tax fraud to the IRS at 1-800-829-0433. Anyone with questions about their own situation can call the toll-free IRS Help Line at 1-800-829-1040.

Participants in such schemes may have to pay any back taxes, interest and penalties, and might even face criminal prosecution. Before entering into any tax avoidance arrangements, taxpayers should seek the advice of a trusted tax professional.

The IRS urges people to avoid these common schemes:

No Taxes Withheld from Your Wages

The IRS has seen a number of illegal schemes that instruct employers not to withhold federal income tax or other employment taxes from wages paid to their employees. These schemes are based on an incorrect interpretation of “Section 861” and other parts of the tax law and have been refuted in court. Employer participants could be held responsible for back payments of employment taxes, plus penalties and interest. Employees who have no withholdings are still responsible for payment of their income taxes.

Return Preparer Fraud

Unscrupulous return preparers can cause a lot of problems for taxpayers who use their services. Abusive return preparers derive financial gain by diverting a portion of the taxpayer’s refund for their own benefit, charging inflated fees for the return preparation services, and increasing their clientele by advertising guaranteed larger refunds. Taxpayers should choose carefully when hiring a tax preparer — no matter who prepares the return, the taxpayer is ultimately responsible for all of the information on that return.

Frivolous Arguments

Frivolous arguments are false arguments that are unsupported by law. When a scheme promoter says “I don’t pay taxes – why should you” or urges you to “untax yourself for \$49.95,” beware. The ads may claim that the promoter knows

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the “secret” for never paying taxes again, but that’s just plain wrong. The U.S. courts have continuously rejected this and other frivolous arguments. Unfortunately, people across the country have paid for the “secret” of not paying taxes or have bought “untax packages.” Then they find out that following the advice contained in them can result in civil and/or criminal penalties.

Identity Theft

Identity thieves use someone’s personal data to steal his or her financial accounts, run up charges on the victim’s existing credit cards, apply for new loans, credit cards, services or benefits in the victim’s name and even file fraudulent tax returns. The IRS is aware of several identity theft scams involving taxes or the IRS. In one example, fraudsters sent bank customers fictitious bank correspondence and IRS forms in an attempt to trick them into disclosing their personal and banking data. In another, abusive tax preparers have used clients’ Social Security numbers and other information to file false tax returns without the clients’ knowledge. For taxpayers, it pays to be choosy about disclosing personal and financial information.

African-Americans Get a Special Tax Refund

Thousands of African Americans have been misled by people offering to file for tax credits or refunds related to reparations for slavery. There is no such provision in the tax law. Some unscrupulous promoters have encouraged clients to pay them to prepare a claim for this refund. But the claims are a waste of money. Promoters of reparations tax schemes have been convicted and imprisoned. And taxpayers could face a \$500 penalty for filing such claims if they do not withdraw the claim. Related scams include claiming an illegal tax credit by misusing Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains.

Share/Borrow EITC Dependents

Unscrupulous tax preparers “share” one client’s qualifying children with another client in order to allow both clients to claim the Earned Income Tax Credit. For example, one client may have four children but only needs to list two to get the maximum EITC. The preparer will list two children on the first client’s return and the other two on another client’s tax return. The preparer and the client “selling” the dependents split a fee. The IRS prosecutes the preparers of such fraudulent claims, and participating taxpayers could be subject to civil penalties.

Improper Home-Based Business

This scheme purports to offer tax “relief” but in reality is illegal tax avoidance. The promoters of this scheme claim that individual taxpayers can deduct most, or all, of their personal expenses as business expenses by setting up a bogus home-based business. But the tax code firmly establishes that a clear business purpose and profit motive must exist in order to generate and claim allowable business expenses.

Social Security Tax Scheme

Taxpayers shouldn't fall victim to a scam offering them refunds of the Social Security taxes they have paid during their lifetimes. The law does not allow such a refund. The scam works by charging the victim an upfront "paperwork" fee of \$100, plus a percentage of any refund received, to file a refund claim with the IRS. The IRS processing centers are alert to this hoax and have been stopping the false claims.

"I Can Get You a Big Refund...For a Fee!"

Refund scheme operators may approach you wanting to "borrow" your Social Security Number or give you a phony W-2 so it appears that you qualify for a big refund. They may promise to split the refund with you, but the IRS catches most of these false refund claims before they go out. And when one does go out, the participant usually ends up paying back the refund along with stiff penalties and interest.

Americans with Disabilities Act

Another scheme seen for several years involves the purchase of equipment and services that the promoter alleges meets the strict criteria of the Disabled Access Credit, which was created with the passage of the “Americans with Disabilities Act”. A minimal payment is made and a non-recourse note signed. The investor then provides insignificant services to complete the purchase agreement. This scheme is based on an incorrect interpretation of law and an over-inflated value of the services rendered.

Credit Counseling Agencies

Many taxpayers seek help from non-profit credit counseling organizations in managing their debt or “repairing” damaged credit, but an increasing number of

complaints to federal and state agencies indicates that some organizations are engaging in questionable activities. Consumers need to be wary of the “quick fixes” offered by some organizations that may actually drive them deeper into debt.

Offshore Transactions

Some people use offshore transactions to avoid paying United States taxes. Use of an offshore bank account, brokerage account, credit card, wire transfer, trust, offshore employee leasing or other arrangement to hide or underreport income or to claim false deductions on a federal tax return is illegal.

Misuse of Trusts

Promoters of abusive tax transactions are increasingly urging taxpayers to transfer assets into trusts. The promoters promise a variety of benefits, such as the reduction of income subject to tax, deductions for personal expenses paid by the trust and reduction of gift or estate taxes. Taxpayers should be aware that abusive trust arrangements will not produce the tax benefits advertised by their promoters and that the IRS is actively examining these types of trust arrangements.

“Claim of Right” Doctrine

In this emerging scheme, people file returns and attempt to take a deduction equal to the entire amount of their wages. The promoters advise them to label the deduction as “a necessary expense for the production of income” or “compensation for personal services actually rendered”. The deduction is based on a complete misinterpretation of the Internal Revenue Code and has no basis in law.

Corporation Sole

Participants in this scam apply for incorporation under the pretext of being a “bishop” or “overseer” of a one-person, phony religious organization or society. The idea is that the arrangement entitles the individual to exemption from federal income taxes as a nonprofit, religious organization as described in tax laws. But the rules have been twisted at seminars where promoters charge fees of up to \$1,000 or more per person. Would-be participants are mistakenly told that Corporation Sole laws provide a “legal” way to escape paying federal income taxes, child support and other personal debts.

Some lessons to remember:

- Anyone who promises you a bigger refund without knowing your tax situation could be misleading you;
- Never sign either a blank tax return or a completed tax return without looking it over to make sure it's honest and correct; and
- Seek advice from a trusted tax professional when offered a chance to participate in any tax avoidance arrangement.

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